The impact of Brexit on financial services

by

Vangelis Tsiligiris

Key terms[1]

- **Passporting:** Financial Services Institutions (FSIs) based in EU member states and non-EU states that are members of the EEA can sell their services freely within the bloc under the passporting system. **This is the existing regulatory arrangement.**
- **Equivalence:** Some non-EEA countries receive preferable market-access rights for certain services, on the basis that their laws and supervisory frameworks are deemed by the European Commission to be "equivalent" to the EU's. **This is one of the proposed post-Brexit regulatory arrangements**.

Financial services (FS) sector overview[2]

174bn economic contribution through 2.3 million jobs across the UK; 1.5 million jobs outside Greater London. The largest tax payer contributing £87bn in tax revenue or 11% of all UK tax raised.

Brexit Scenarios

Scenario 1: No deal Brexit (possible scenario)

In this scenario UK will be treated as a third country for EEA and vice versa. To avoid disruption the UK government has announced that is willing to use a Temporary Permissions Regime (TRP). This will allow the existing EEA FSIs to continue operating in the UK for 3 years. After that period, they would need to seek permission by the Financial Conduct Authority (FCA) to establish in the UK. UK firms will trade with the EU under the World Trade Organisation guidelines.

Scenario 2: Bespoke deal (most likely scenario)

In this scenario, the UK will strike a deal with the EU that will allow preferable market-access rights to FSIs. This kind of deal will be based upon the equivalence principle. However, it will take many years to finalise and will be along the lines of existing deals between the EU and third countries (e.g. Canada).

Scenario 3: EEA status (least likely scenario)

Passporting is maintained but the UK cannot influence EU regulations. Following the white paper on Brexit by the UK government[3], this scenario is unlikely to happen. In the white paper there is a clear statement that the Government is prioritising to implement the will of the people to leave the single market and as such there is no intention to seek post-Brexit access to the common market.

Impact on core sectors

Retail Banking

For EEA FSIs offering banking retail services to UK customers there is a clear process in place already (see TPR) which minimizes the potential disruption. The same does not apply to UK FSIs offering retail banking services to EEA customers. On the latter, the EU has not announced any interim arrangements to facilitate passporting in the event of a no deal. The cost of card payments between the UK and the EU will likely increase, and these cross-border payments will no longer be covered by the surcharging ban[4].

Wholesale Banking

Considering the scale of wholesale banking operations that goes through the UK, it is expected that there will be mutual recognition for wholesale financial services on the basis of equivalence of outcomes rather than regulatory replication. The UK might adopt a more accommodating approach towards incoming FSIs to support its global status. Irrespective these developments, and in the context of the EU statement that it will not accept "empty shells" as subsidiaries of UK FSIs in EEA countries, it is expected that wholesale

---

[1] https://www.accaglobal.com/content/dam/ACCA_Global/professional-insights/brexit-impact-on-financial-services/pi-Brexit-impact-FS-2.0.pdf
[2] https://www.thecityuk.com/assets/2018/Reports-PDF/bf5f754f60/An-engine-for-growth.pdf
[3] https://www.gov.uk/government/publications/the-future-relationship-between-the-united-kingdom-and-the-european-union
[4] https://www.gov.uk/government/news/card-surcharge-ban-means-no-more-nasty-surprises-for-shoppers

firms will experience increased cost to set up and maintain operations across different locations within the EEA.

Insurance[5]

Loss of passporting would have an impact on both UK and EEA insurance firms. EEA firms currently having a branch in the UK on the basis of inbound passporting, will need to seek authorization by the Prudential Regulation Authority (PRA) to continue their UK operations as branches of a third country firm. Considering the lack of clarity about the post-Brexit regulatory status, it is suggested that insurance firms seem authorisation by PRA before Brexit is concluded.

Impact on different market segments

- **UK to UK:** no major impact and largely unaffected. Transaction costs likely to increase if access to European payment system is lost. The government is prioritising to maintain post-Brexit compliance with the European payment system as third country.
- **UK customers of EEA firms:** largely unaffected with the implementation of TPR.
- **EEA customers of UK firms operating in the EEA:** serious disruption if passporting is not maintained.

Overall impact under all scenarios and across all key sectors

- Brexit will be long process rather than an instantaneous event. The existing regulatory framework in FS, including passporting, will remain in place during the post-Brexit transition period (until 31 December 2020). A critical aspect would be the potential for an extension in the post-Brexit transition period.
- Irrespective of the negotiations outcome, the impact on regulatory environment would not lead to an immediate divergence. EU law is already ported in the UK law. There might be modifications in the legal framework, but this will take place very gradually after Brexit.
- A common unknown under all scenarios for all FSIs is the macroeconomic conditions that will emerge as outcome of Brexit that would be likely to affect the FS sector, especially in the context of a possible recession and the subsequent course of monetary policy.
- Irrespective of the outcome of the negotiations and considering their European market focus, UK-based FSIs ought to remain complaint to the EU regulation (i.e. MIFID II). The effort and cost to achieve this will depend upon the Brexit deal on FS.

An emerging post-Brexit business model

So far, the most prominent realised impact of Brexit has been on the business model of large FSIs. Brexit has pushed FSIs to rethinking their strategic approach and specifically to shift from a "serve everything from London" to a "serve from where appropriate" model. Irrespective of the outcome of the Brexit negotiations, the future model of FSIs would be one that involves a dispersed and segmented operation across several locations in the EEA.

Relation to IT and IMS

The emerging post-Brexit business model for FSIs will increase the need for information technology (IT) and information management systems (IMS) that will facilitate the smooth operation of a multi-location internal network. Additionally, if this takes place within a no-deal post-Brexit regulatory environment, there will be the need for regulatory compliance in each location. Considering the expected relocation of jobs, there would be an ongoing need for staff training on the use of IT systems. In this context, here are some of the post-Brexit considerations for FSIs in relation to data management, IT, and IMS:

- Identify data requirements under the new operating model and maintain compliance with data protection laws applicable in each location.
- Design and implement change to IT infrastructure in relation to market infrastructure access and new premises.
- Design and implement changes to software and applications in relation to the new operating model (e.g. changes in processes, controls, and reporting).

[5] https://www.ey.com/Publication/vwLUAssets/EY-Brexit-for-insurance/$FILE/EY-Brexit-for-insurance.pdf